

April 18, 2006

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

regcomments@ncua.gov

Dear Ms. Rupp,

Please accept the attached group response and comments to the NCUA's advance notice of proposed rulemaking on the rules for Supervisory Committee audits.

Although we understand the NCUA's desire and need to modify audit regulations in response to GAO and other governmental pressures, we absolutely do not see any benefit to the credit union movement having audit requirements more stringent than other types of financial institutions.

The regulatory environment for types of financial institutions other than credit unions must heavily focus on financial performance to appease a limited number of stockholders that have a very intense interest in financial performance. In addition, other types of financial institutions must have access to various capital markets requiring financial reporting beyond the level needed for most credit unions. The primary users of financial statement data and reporting for financial institutions other than credit unions are myriad and would seek additional assurance on the adequacy of financial reporting to make sound investment decisions.

The same benefits to added levels of assurance on financial reporting would not accrue to members of most credit unions. The additional costs and resources allocated to the proposed higher levels of assurance on financial reporting would only benefit regulators and not the individual members of the credit union industry.

This response comes collectively from the following League Auditors:

- Alabama Credit Union League, Clay Morgan, Vice President Auditing Services
- Georgia Credit Union League, Laura Gober, Director Compliance Services
- Massachusetts/New Hampshire/Rhode Island Credit Union Leagues, Kathy Enderlin, Senior Vice President, Audit Services
- Oklahoma Credit Union League, Dana Kroutil, Director-Audit
- Pennsylvania Credit Union Association, Chris Feather, Senior Auditor
- South Carolina Credit Union League, LaTasha Cooper, Internal Auditor
- Texas Credit Union League, Chad Stanislav, Vice President Financial/Technology Resources
- Utah League of Credit Unions, Russell Dickson, Audit Manager
- West Virginia League Services Corporation, Jenny Reynolds, Director Auditing Services

**Comments on NCUA Regulation Part 715
Advance Notice of Proposed Rulemaking
Supervisory Committee Audits**

1. *Should Part 715 require, in addition to a financial statement audit, an “attestation on internal controls” over financial reporting above a certain minimum asset size threshold? Explain why or why not.*

If an “attestation on internal controls” over financial reporting should be required for credit unions, the asset threshold should be no less than \$1 billion dollars. Credit unions are extremely limited by regulations regarding the types of services they can offer, do not have stockholders, and are not publicly held corporations as are other financial institutions. Although credit unions have certain characteristics in common with banks, they differ widely in their structural and operational characteristics. The primary users of the financial statements are internal management and regulators; and the primary goal of an attestation engagement is to provide assurance of the accuracy of the financial statements. Credit unions generally do not require the level of assurance necessary in the banking environment which answers to numerous stockholders with specific interests in financial performance. Credit unions are member-owned financial cooperatives with individual members having equal representation in electing board members and in other decisions. Although credit unions may have a branch in a foreign country, they do not offer services on a global level. Due to all of these limitations, credit unions under \$1 billion dollars in assets should not be required to have an “attestation on internal controls” over financial reporting.

2. *What minimum asset size threshold would be appropriate for requiring, in addition to a financial statement audit, an “attestation on internal controls” over financial reporting, given the additional burden on management and its external auditor? Explain the reasons for the threshold you favor.*

If an “attestation on internal controls” over financial reporting must be required of credit unions, the minimum asset size threshold should be credit unions with assets of \$1 billion or more. This level would be equivalent to banking requirements.

3. *Should the minimum asset size threshold for requiring an “attestation on internal controls” over financial reporting be the same for natural person credit unions and corporate credit unions? Explain why.*

Natural person credit unions and corporate credit unions should be treated the same. Even though corporate credit unions offer varying services from natural person credit unions, corporate credit unions still do not offer the wide array of services that other types of financial institutions have the corporate structure and authority to provide.

4. *Should management’s assessments of the effectiveness of internal controls and the attestation by its external auditor cover all financial reporting, (i.e., financial statements prepared in accordance with GAAP and those prepared for regulatory reporting purposes), or should it be more narrowly framed to cover only certain types of financial reporting? If so, which types?*

If an “attestation on internal controls” over financial reporting must be required of credit unions, management’s assessments of the effectiveness of internal controls and the attestation or review by its external auditor should only cover regulatory call reporting. To require any additional attestation engagements would certainly be a significant cost burden for credit unions.

5. *Should the same auditor be permitted to perform both the financial statement audit and the “attestation of internal controls” over financial reporting, or should a credit union be allowed to engage one auditor to perform the financial statement audit and another to perform the “attestation on internal controls?” Explain the reasons for your answer.*

If an “attestation on internal controls” over financial reporting must be required of credit unions, then any auditor chosen by the credit union should certainly be permitted to perform both the financial statement audit and the “attestation of internal controls”. A great deal of duplication of effort and costs would be required if two different auditors were performing these two functions. This would only increase an already very costly procedure.

6. *If an “attestation on internal controls” were required of credit unions, should it be required annually or less frequently? Why?*

If an “attestation on internal controls” must be required of credit unions, it should not be required annually due to the extremely expensive cost of this procedure and due to the intensely regulated environment in which credit unions must operate. Ultimately, the changing nature of the business environment and the complexity of the credit union should dictate the frequency of the need for an “attestation of internal controls”. For most \$1 billion+ credit unions, a three or even five year interval between “attestations on internal controls” should be sufficient.

7. *If an “attestation on internal controls” were required of credit unions, when should the requirement become effective (i.e., in the fiscal period beginning after December 15 of what year?*

If an “attestation on internal controls” over financial reporting must be required of credit unions, the requirement should become effective no earlier than 24 to 36 months after promulgation of rules by the NCUA. This would allow the credit unions that are affected by the attestation requirements the time they will need to put proper policies and procedures in place and to test those policies and procedures before being audited.

8. *If credit unions were required to obtain an “attestation on internal controls,” should Part 715 require that those attestations, whether for a natural person or corporate credit union, adhere to the PCAOB’s AS 2 standard that applies to public companies, or to the AICPA’s revised AT 501 standard that applies to non-public companies? Please explain your preference.*

If an “attestation on internal controls” over financial reporting must be required of credit unions, Part 715 should require the AICPA’s revised AT 501 standard that applies to non-public companies. PCAOB’s AS 2 standard is highly complex and, therefore, extremely expensive. Further, since the PCAOB’s AS 2 standard was designed for public companies, the requirements and complexities far outweigh any requirements that would be needed for credit unions.

9. *Should NCUA mandate COSO's Internal Control – Integrated Framework as the standard all credit union management must follow when establishing, maintaining and assessing the effectiveness of the internal control structure and procedures, or should each credit union have the option to choose its own standard?*

If the NCUA requires management to document the nature and effectiveness of internal controls and third-party attestation engagements of management's assertions, then the NCUA should consider only COSO's (Committee of Sponsoring Organizations of the Treadway Commission) Internal Control – Integrated Framework as a standard that all credit unions greater than \$1 billion in assets must follow. By having all CU's over \$1 billion using only the COSO standard will provide continuity and consistency to measure and evaluate various financial institutions.

10. *Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have a minimum level of experience or expertise in credit union, banking or other financial matters? If so, what criteria should they be required to meet and what should the minimum asset size threshold be?*

For credit unions with assets over \$3 billion, there could be a requirement for the Supervisory Committee to have a minimum level of experience or expertise in credit union, banking or other financial matters since the FDIC has a similar threshold. However, if the credit union can prove a hardship in recruiting and retaining members who have a minimum level of experience, this requirement should be waived by the NCUA. The banking environment has the luxury of paying committee members and credit unions must find unpaid individuals to serve as voluntary officials. Additionally, qualified Supervisory Committee membership is difficult to recruit under current regulations and would be even more difficult with these added regulations.

11. *Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have access to their own outside counsel? If so, at what minimum asset size threshold?*

For credit unions with assets over \$3 billion, the Supervisory Committee should have the ability to contract with any outside counsel at their discretion. Credit unions of any size should allow their Supervisory Committee to engage with outside counsel as they deem necessary and appropriate to conduct their required duties.

12. *Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be prohibited from being associated with any large customer of the credit union other than its sponsor? If so, at what minimum asset size threshold?*

Safeguards currently in place in various NCUA regulations already prohibit or limit the size of various loans concentrated with any single member and therefore would limit the exposure of the credit union by a member of the Supervisory Committee from being associated with any large customer of the credit union or sponsor.

13. *If any of the qualifications addressed in questions 10, 11 and 12 above were required of Supervisory Committee members, would credit union have difficulty in recruiting and retaining competent individuals to serve in sufficient numbers? If so, describe the obstacles associated with each qualification.*

Ultimately any restrictions on the qualifications of Supervisory Committee members would make the recruitment and retention of qualified committee members even more difficult than current standards. The volunteer committee could increase their expertise or knowledge by hiring an internal auditor, whether in-house or as an outsourced audit function.

For credit unions with assets over \$3 billion, the Supervisory Committee should have the ability to contract with any outside counsel at their discretion. However, any credit union of any size should allow their Supervisory Committee access to the resources to engage with outside counsel as deemed necessary.

The requirement regarding Supervisory Committee members to be prohibited from associations with any large customer of the credit union other than the sponsor should be addressed as a recommendation through the NCUA examination process and not a regulatory obligation.

14. *Should a State-licensed, compensated auditor who performs a financial statement audit and/or “internal control attestation” be required to meet just the AICPA’s “independence” standards, or should they be required to also meet SEC’s “independence” requirements and interpretations? If not both, why not”*

Financial statement opinion audits and/or “internal control attestation” required by NCUA regulations should only be performed by a State-licensed, compensated auditor who meets the AICPA’s “independence” standards. We see no benefit to a State-licensed, compensated auditor also meeting the SEC’s standards for “independence”. The SEC’s requirements are much more complex and are more appropriate for publicly traded companies.

15. *Is there value in retaining the “balance sheet audit” in existing Part 715.7(c) as an audit option for credit unions with less than \$500 million in assets?*

We see no benefit to eliminating a viable option already under current NCUA regulations. Although this option may not be frequently used by credit unions to satisfy their annual requirements; the option should remain available to all credit unions.

16. *Is there value in retaining the “Supervisory Committee Guide audit” in existing Part 715.7(c) as an audit option for credit unions with less than \$500 million in assets?*

The “Supervisory Committee Guide” audit is an important option for credit unions under \$500 million in assets. This is the only option that does not require a CPA to perform the audit. Without this option, an undue financial burden will be placed on many credit unions. The higher costs could force some credit unions into a merger situation.

League audit programs and other non-CPA’s who regularly perform the “Supervisory Committee Guide” audit are more typically knowledgeable about credit union services, accounting and regulations specific to the credit union industry than some CPA firms that only perform minimal work for credit unions. Many large CPA firms send their “rookie” auditors to credit unions because there is not a big profit margin for auditing these engagements. This provides training for new auditors – the credit union explains what a share account is and some of the unique accounting such as the allowance for loan and lease losses methodology.

A credit union specialist does not necessarily have to be a CPA. If the Supervisory Committee audit option were not available to credit unions, non-CPAs would no longer be able to offer to do the annual audit for credit unions. CPAs could then charge a higher amount to do the audit for these credit unions because there would be no competition offering a competing and typically more economical fee. The higher fees would create a financial burden for these smaller credit unions.

The elimination of the Supervisory Committee audit option would also put an undo burden on credit unions with assets less than \$10 million. The vast majority of credit unions with assets less than \$10 million utilize the Supervisory Committee audit as their annual audit option and rely heavily upon League audit programs and other non-CPA's to provide these annual services. In addition, these smaller credit unions would also be required to conform to GAAP for audit purposes which could prove to be an undo burden.

The Supervisory Committee audit option currently allowed by the NCUA is also similar, if not more stringent, than the "Directors Examination" available to banks with assets under \$500 million, as described in the "Comptroller's Handbook" published by the Comptroller of the Currency.

The "Supervisory Committee Guide" audit is clearly an important option for credit unions since 66% of all credit unions utilize this option. Recent national statistics provided by CUNA (from Call Report data) indicated the following options used by credit unions to complete their annual Supervisory Committee Audit requirements:

Audit Option	Number of Credit Unions Using Audit Option	Average Assets - Credit Unions Using Option
Financial Statement Audit or CPA Opinion Audit	2619	\$207,427,121
Balance Sheet Audit	252	\$47,489,284
Audit of Internal Controls	74	\$77,970,352
Audit by State Licensed Auditors or Agreed Upon Procedures Engagements	1,756	\$29,155,055
Audit by Other External Auditors (Leagues)	2,956	\$25,056,752
Audit by Supervisory Committee or Staff	1,143	\$5,266,272

17. *Should Part 715 require credit unions that obtain a financial statement audit and/or an “attestation on internal controls” (whether as required or voluntary) to forward a copy of the auditor’s report to NCUA? If so, how soon after the audit period end? If not, why not?*

No copy of the auditor’s report or the “attestation on internal controls” should be required to be sent to NCUA by the external auditor. The auditor’s report is available at the credit union and is reviewed during NCUA’s Examination of the credit union. If an “attestation on internal controls” is required or is performed voluntarily, it could also be reviewed by the NCUA Examiner during the examination process of the credit union.

18. *Should Part 715 require credit unions to provide NCUA with a copy of any management letter, qualification, or other report issued by its external auditor in connection with services provided to the credit union? If so, how soon after the credit union receives it? If not, why not?*

The management letter, qualification, or other report issued by the credit union’s external auditor is now available at the credit union for NCUA Examiners to review during on-site examinations, and no requirement is necessary for an external auditor to provide these documents directly to the NCUA.

19. *If credit unions were required to forward external auditors’ reports to NCUA, should Part 715 require the auditor to review these reports with the Supervisory Committee before forwarding them to NCUA?*

The external auditors’ reports should not be required to be forwarded to NCUA (see #17 and 18 above). Direct communications between the Supervisory Committee and external auditors is certainly an industry standard at this time and changing NCUA regulations will provide no further benefit.

20. *Existing Part 715 requires a credit union’s engagement letter to prescribe a target date of 120 days after the audit-period end for the delivery of the audit report. Should this period be extended or shortened? What sanctions should be imposed against a credit union that fails to include the target delivery date within its engagement letter?*

The increasing complexity of the credit union business environment makes the delivery of audit reports within the prescribed target date of 120 days increasingly difficult. Sometimes an audit requires additional time for investigation or confirmation of a significant item. Sometimes the audit firm is hired after the audit-period end date (for example: an audit firm receives a December 31, 2005 engagement letter on February 25, 2006). Auditors face a great deal of difficulty within the current regulations to do the preparation, scheduling, performance of the audit and perform the proper review and deliver the audit report within the 120 day deadline. In order to satisfactorily complete all of the required elements of the audit process we suggest the target delivery date for audit reports should be 180 days after the audit-period end.

The current NCUA regulations require the target delivery date be included in the engagement letter with any external auditor. The NCUA should address any problems at individual credit unions through the annual regulatory examination process (i.e., Document of Resolution, when appropriate).

21. *Should Part 715 require credit unions to notify NCUA in writing when they enter into an engagement with an auditor, and/or when an engagement ceases by reason of the auditor's dismissal or resignation? If so in cases of dismissal or resignation, should the credit union be required to include reasons for the dismissal or resignation?*

The credit union should not be required to notify NCUA in writing when they enter into an engagement with an auditor or when an engagement ceases by reason of the auditor's dismissal or resignation. The NCUA's current examination process will provide all pertinent information about the external auditor chosen by the Credit Union.

22. *NCUA recently joined the final Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters. 71 FR 6847 (Feb. 9, 2006). Should credit union Supervisory Committees be prohibited by regulation from executing engagement letters that contain language limiting various forms of auditor liability to the credit union? Should Supervisory Committees be prohibited from waiving the auditor's punitive damages liability?*

We agree that Supervisory Committees should be prohibited from engaging with auditors under the terms of engagement letters that limit auditor liability or prohibit the auditor's liability for punitive damages.